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ARE WE SEEING A SHIFT IN CORPORATE STRATEGIC BEHAVIOUR TODAY?

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Dramatic business and economic events of the past decade are inducing far-reaching changes in how firms behave. One of the more conspicuous changes is in competitive behavior, where conventional patterns have given way to alternative, systemic approaches. This is behavior in which the firm seeks continuity and domination by achieving an absolute competitive advantage in two prime business drivers: capital and competencies. In this article, readers will learn why seven prominent corporations changed course and adopted what the author refers to as systemic strategic behaviour.

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CORPORATE STRATEGIC BEHAVIOUR: THE CASES

One of the striking features of the past decade is the large number of corporations who considered making rather unconventional, strategic moves in search of one or more goals. In this article, I have chosen seven corporations whose strategic moves and end goals illustrate the circumstances and reasons for making the change in competitive behaviour. Each of the seven is discussed below. I then describe the four patterns of behaviour that drove the changes.

1. P&G and Gillette: Acquisition in search of industry domination. The merger of P&G and Gillette in 2005 created the world's largest consumer- products conglomerate, as well as a serious degree of industry domination. Procter & Gamble was already the largest consumer-products company in the U.S., making a wide variety of products and brands from Pampers and Tide to Crest and Head and Shoulders. Gillette's products included not only its signature razors, but also its Duracell batteries, Braun electrical appliances and Oral-B dental-care items. Both companies complemented each other. Their synergies covered markets, brands, technologies and strategic competencies

A straightforward equity swap was P&G's vehicle of choice to consummate the Gillette takeover. The acquisition agreement provided for the exchange of 0.975 shares of Procter & Gamble common stock, on a tax-free basis, for each share of Gillette, valuing the stock at $53.94, a premium of about 18 percent at the time of the transaction (WSJ, P&G to Buy Gillette for $54 Billion, January 28, 2005).

2. Mittal and Arcelor: A merger in search of absolute competitive advantage. Mittal's search for greater market share and industry dominance fuelled a takeover bid for Arcelor and a €25.8 billion takeover package. Arcelor rejected the offer, citing a better marriage partner in Russia's Severstal who, in Arcelor's eyes, offered a unique blend of operations in Brazil and Russia, a low-cost cost way of doing business and high profitability. It also attempted to sway shareholders with a 150-million share buy-back offer at the generous price of €44 per share. Mittal prevailed by projecting an optimistic outlook of profitability and ambitious investment and expansion plans, especially in emerging markets (*The Economist*, June 15, 2006). An agreement to combine the two companies in a merger of equals and create the world's leading steel company was finally announced in June, 2006.

Investors' gain or gains played a central role in Arcelor's attempt to sway shareholder interest. Mittal's promising industry and investment outlook seems to have been the deciding factor in the final decision.

3. Lenovo and IBM: An acquisition in search of new competencies. Lenovo, the Chinese information technology multinational, and the world's 2011 second-largest PC maker, acquired IBM's personal computer division in 2005. The stated motive was to create a strategic alliance with a leader in the (laptop) industry and assume a leading position in the global market. The unstated goal was to benefit from IBM's technology and marketing prowess. Lenovo today is a dominant supplier of computers in China and the second-largest supplier of personal computers worldwide (13.5 percent of the global computer market in October 2011).

Lenovo paid IBM $1.25 billion in cash and common shares, and it assumed approximately $500 million of net balance-sheet liabilities.

4. Carlyle and Firth Rixson : A takeover in search of maximum returns. The British firm, Firth Rixson, was acquired by Carlyle in 2003 for U.S.$ 102.00 million, at today's exchange rate. The company manufactured highly engineered, forged-cast and other specialty metal products for the aerospace industry. In Firth Rixon, Carlyle saw a unique niche, an attractive market, a distinct technology and a solid asset base. Firth Rixson was to be developed into a global supplier of parts to multinational jet engine makers and other industrial customers. It merged with another Carlyle holding, Forged Metal, in 2005, and two other technology firms in 2004 and 2007. Today, Firth Rixson is a leading supplier of highly- engineered specialized metal products to aerospace engine manufacturers. It operates 11 facilities across China, Europe and the United States, and supplies products to every major aerospace engine manufacturer in the world. (Carlyle annual report, 2007)

In 2008, Firth Rixson was taken over by Oak Hill Capital Partners, yet another private equity firm. This transaction involved approximately £€45 million ($2.0billion), a multiple of what Carlyle paid way back in 2003.

5. RBS and ABN AMRO: A competency divestment in search of survival. A decade ago RBS rose to global prominence as one of the world's largest financial institutions, only to stumble and tumble into quasi-bankruptcy in 2008. A strategy of aggressive acquisition, including that of ABN AMRO of the Netherlands, eventually proved disastrous. RBS' massive underwriting, including that of Collateralized Debt Obligations, linked its fate to the subsequent collapse of the securitization industry in the United States. And RBS' shift from funding its lending positions fully from deposits ("fully funded") — to external wholesale funding, especially of global banking operations, signaled an impending crisis.

RBS' attempts to raise capital failed. Ultimately, RBS was forced to resort to a British government bank-rescue package, one that led to a 70-percent government equity ownership (*Observer*, 1 February 2009) (El Namaki, 2009).

The capital markets declined to offer financial support to RBS, which had no choice but to dispense with its non-core assets.

6. HP's PSG (Personal Systems Group): A competency divestment in search of financial focus. HP's decision to disband its Personal Systems Group (PSG) was a response to financial realities and the desire, as HP put it, to "demonstrate a commitment to enhance shareholder value and sharpen strategic and ….. financial focus." The Group, though once a PC- market leader in terms of units, revenue and profit share, had been experiencing persistent revenue and margin decline. HP saw this as a reflection of changing market conditions, such as customer requirements, and secular market trends that were redefining how technology is consumed and deployed.

Thus, declining market share and shrinking profitability triggered HP's decision to divest PSG, despite the strategic position of the SBU within HP and in the market.(WSJ, H-P Explores Quitting Computers as Profits Slide August 19, 2011)

7. Kodak: An example of financial entropy. Way back in 1976, Kodak accounted for 90 percent of film and 85 percent of camera sales in the United States. Digital photography changed that. Kodak's revenues declined from approximately $16 billion in 1996 to $6.2 billion in 2011. Losses, and declines in employment and share price followed (*The Economist*, Jan.2012).

Kodak's strategies and leadership have been inconsistent over the years. The latest strategy shift, around 2005, focused on digital printing and the conversion of the firm's huge portfolio of intellectual property into a financial asset. Both measures were too late. A restructuring attempt that followed was equally ill timed and executed. Low returns, especially returns on innovation, have accelerated Kodak's demise.

CORPORATE STRATEGIC BEHAVIOUR: THE PATTERNS

The cases analyzed above contain a strategic common denominator, i.e. the search for a foundation for long-term continuity. They also illustrate what I referred to earlier as "systemic strategic behaviour."

Turbulence, economic or otherwise, is undermining some key, longstanding tenets of corporate growth and leaving corporations in a state of greater uncertainty than ever. This is an unusual state, given the era of expansion that accompanied President Ronald Reagan's free-market policies and the ensuing decades of growth in output and trade. Corporations are trying to cope with this uncertainty by achieving a high level of industry domination and/ or building a portfolio of competencies that are difficult to challenge. Setting and trying to achieve these goals is an example of **systemic strategic behavior**, a mode whereby the firm seeks domination and continuity by attaining and sustaining an absolute competitive advantage in capital resources and competency profile. Failing that, it seeks an end-game scenario.

There are four types of systemic strategic behaviour.

1. **Seeking concentration.** To follow such a strategy, the player or players embark upon a merger and acquisition that would limit the number of competitors to a specific, high-concentration norm and create, in the process, forbidding barriers for those players who may contemplate entering the market. A four-firm concentration ratio of 80 percent is considered, by all standards, high, and can be found in several key industries in the United States and the UK. P & G pursued a "seek-concentration strategy." Acquisition and merger was the medium, and a convenient equity swap made the strategy feasible. Mittal followed suit.
2. **Seeking competencies.** This is a strategy whereby a corporation acquires a competency in order to enhance or even create a core competency. Lenovo is a good illustration. The company was in search of both technology and marketing competencies in the laptop industry and IBM had them. Carlyle enhanced the engineering competencies of Firth Rixson and, through a merger with another technology firm, created a core competency.
3. **Seeking focus.** This strategy connotes a firm's rationalization of its competency profile by divesting non-core competencies. We have witnessed that in the case of RBS and its disposal of a number of businesses it considered non-essential under the emerging post-subprime crisis. HP went through a similar process with the divestment of its personal computing division.
4. **Seeking an end game.** This is a state of instability that could lead to atrophy or end game. In this situation, the capital markets are despondent and the competency profile is moribund. The best example could be Kodak, with the loss of an obsolete competency, chemical photography, and the slow pace of adopting an emerging technology. Kodak did try to pursue a "seeking focus" strategy but events followed a fast pace and overtook management's plans.

To summarize, the strategies are those of seeking concentration, competencies seeking focus and end game. The vehicles are acquisition, merger and divestment.

HOW DO SYSTEMIC STRATEGIES EVOLVE? AND WHAT IS THE CONCEPTUAL FRAMEWORK?

Systemic strategies could emerge as a result of two prime forces: the dynamics of the investment capital market and the firm's future competency intent.

Global capital markets are in a state of turmoil. Players (investment banks, private equity funds etc), products (e.g., structured finance instruments) monitors (credit rating agencies) and regulators (e.g. The Securities and Exchange Commission) are going through massive changes. Recently, much of this change has been more negative than positive. The subprime crisis and all that followed cast a dark shadow over the industry as a whole. Investment banks have lost their focus, private equity shrank in terms of scope and reach, hedge funds faced investment capital recalls and even sovereign funds contracted in the face of well-publicized failures. This activity has impacted the ability of corporations to finance growth and expansion through equity or debt. Equity supply is projected to decline over the next decade, at a time when deleveraging will become a standard prescription (McKinsey, 2012).

Corporations are painfully aware of those threats and are seeking solutions. An obvious solution is internal financing. A high measure of industry concentration, whereby the corporation in question is the lead player, could generate greater revenues, produce wider margins, deliver higher levels of retained earnings and finance growth.

Yet, internal capital resources are not enough to effect a change to "systemic strategic behavior." Solid competencies provide the second, necessary half of the formula. A core competency (Prahalad, Hamel 1990) is essential. This core competency could be a business-performance measure that is not easy for competitors to imitate, can be used across products and markets, and does contribute to end consumer benefit. Together, these could provide a foundation for the concentration drive, and constitute, in the longer term, an unbeatable strategic competitive advantage.

The views expressed above could be converted into a conceptual framework with two key variables: investment capital resource base and firm competency profile (see figures (1) and (2) below). A combination of either of the two states of each variable leads to one systemic strategic behavior or the other For example, a strong investment-capital resource base, if combined with a strong competency profile, could lead to the “Seeking concentration strategy.” The opposite, weakness on both counts, could lead to a search for an end game. The two other states are those with weakness in capital-resource base and strength in competencies that lead to competency divestment. The opposite would lead to competency acquisition.

Figure (1) Novel patterns of corporate strategic behavior : conceptual model

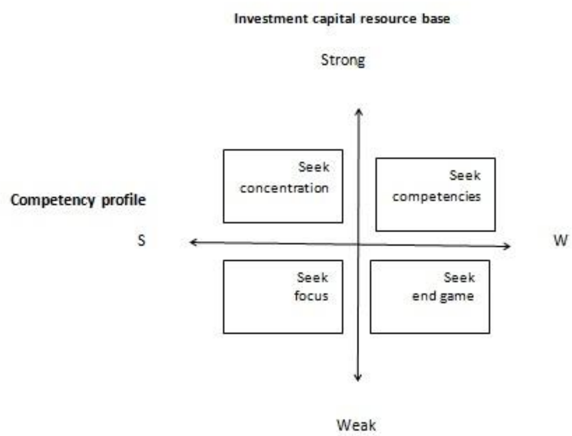
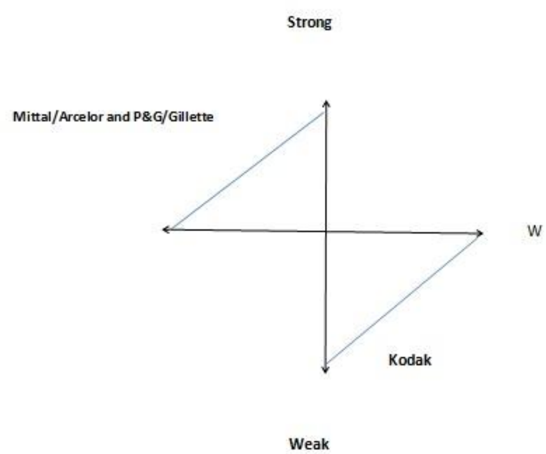


Figure (2) Novel patters of corporate strategic behavior, case illustration



Dramatic business and economic events of the past decade are inducing far-reaching change in the competitive behavior of firms. Conventional patterns are giving way to non-conventional approaches. An analysis of the strategic behavior of seven corporations reveals a fundamental shift towards what we have termed “systemic strategic behavior.” This behavior manifests itself in one of 4 strategies: seeking concentration, seeking competencies, seeking focus, or seeking an end game. These patterns are the outcome of a turbulent investment capital market with declining equity input deleveraging, as much as a pressing search for unique strategic competitive competence.

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